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Rating Action: Moody's affirms South Carolina Public Service Authority's outstanding senior debt at A2; Assigns A2 rating to 2020 Tax-Exempt Refunding and Improvement Series A and 2020 Taxable Refunding Series B Bonds;; Rating outlook is revised to stable

20 Oct 2020

New York, October 20, 2020 -- Moody's Investors Service has affirmed South Carolina Public Service Authority's (Santee Cooper or the Authority) A2 rating on its revenue obligation bonds and has assigned an A2 rating to Santee Cooper's \$363.1 million of Revenue Obligations, 2020 Tax-Exempt Refunding and Improvement Series A and \$300.4 million of Revenue Obligations, 2020 Taxable Refunding Series B. Santee Cooper's rating outlook is changed to stable from negative.

RATINGS RATIONALE

Today's rating action reflects the resolution of a class action lawsuit related to the 2017 abandonment of construction at the V.C. Summer nuclear power plants Units 2 and 3 (Summer), which places an upper limit on the financial obligations associated with the lawsuit between the Authority and Central Electric Power Cooperative Inc. ("Central"), Santee Cooper's largest customer.

The terms of the settlement involve a \$200 million payment from Santee Cooper payable over the next three years beginning in 2020. Also, as part of the settlement, Santee Cooper is required to hold base rates for the substantial majority of its customers to levels reflected in the Reform Plan it submitted to the General Assembly in January of this year through the end of 2024. We view this aspect of the settlement as credit negative as a multi-year rate freeze is generally not consistent with a utility with unregulated rate setting ability that is otherwise determined by its board of directors to recover its costs. Santee Cooper anticipates that declining lower operating costs related to lower fuel costs will help mitigate the rate freeze impact over the next several years. Additionally, Santee Cooper planned debt refunding of several series of higher cost debt will provide interest costs savings that when coupled with other cost savings should provide Santee Cooper with sufficient headroom to enable it to reach its targeted fixed charge coverage ratio (FCCR) of between 1.35x to 1.40x during the rate freeze period. While the rate freeze when combined with Santee Cooper's high leverage reduces the Authority's financial flexibility over the next few years, the settlement constructively addresses a material credit overhang for Santee Cooper particularly since the tenor of the rate freeze is four years. That said, high leverage following the termination of the Summer project will persist for many years which is likely to chronically pressure the Authority's ability to recover costs while maintaining its cost competitiveness. Although the utility has new debt issuance plans of about \$92.4 million as part of the planned financing, debt outstanding is expected to decline to \$5.7 billion by 2025, a \$1.1 billion or 16% decline from the \$6.8 billion level outstanding as of FY 2019.

The rating action also reflects Santee Cooper's monopoly position in serving over one-third of the state's population, or approximately 2 million customers in all 46 counties of the state either through wholesale power sales to Central (58% of sales; wholesale contribute 63% of the Authority's revenues in aggregate) and its 20 distribution cooperatives, or retail (185,000 customers) (24% of sales) to areas such as Myrtle Beach or direct sales to some of the largest industrial firms in the state (13%) and to military installations. In that regard, we note that an October 13th ruling ended a dispute between Santee Cooper and the City of Goose Creek, on the right to service Century Aluminum, finding that Santee Cooper's right to serve the facility in the current location was established by the state's General Assembly many decades ago. While Century Aluminum not a material share of the Authority's revenue base, we view this decision as a credit positive since it is one of Santee Cooper's legacy customers and helps to fortify its monopoly position within its service territory.

As of September 30, 2020, Santee Cooper had \$541 million of unrestricted cash, corresponding to approximately 153 days cash on hand (DCOH). Management forecasts liquidity to remain at around 115-120 DCOH over the next four years, with some strengthening anticipated after 2025, when the base rate freeze period is over. This level of liquidity is lower than the 300 three year DCOH average for the 2017-2019 period, as a result of the \$360 million par debt defeasance using cash on hand during the year. Santee Cooper's FCCR for FY 2019 is 1.32x excluding the non-cash financial impact of the \$200 million legal settlement liability

recorded during the year, which is somewhat lower than the 1.45x 3-year FCCR average from 2016-2018. As the cash flow impact of the settlement will occur over a three year period beginning in 2020, the FCCR is expected to be in the 1.35 -1.40x range in FY 2020 and going forward, while the debt ratio and adjusted debt ratio should begin a gradual decline from the current high levels of 119% and 131%, respectively, as of FY 2019, owing principally to planned amortization and modest future borrowing requirements.

To date, Santee Cooper's financial performance has been modestly affected by the coronavirus crisis, as the Authority maintains some flexibility to adjust to a decline in load and some increased costs related to COVID-19. Decreased power usage is being mitigated by fuel cost efficiency savings and other operating cost adjustments of \$17.5 million as well as a \$59 million reduction in capital expenditures relative to budget. Further, Santee Cooper has been able to unlock additional savings by hedging fuel costs through 2024 and entering into new coal commodity and transportation contracts which will generate around \$88 million in savings through 2024. Also, half of the additional expenses related to COVID-19 are expected to be recovered from the Federal Emergency Management Agency (FEMA). For the year, Santee Cooper anticipates load being 8% lower than original expectations; however weather adjusted load through August 2020 is 3% higher than the Authority's revised expectations. Account delinquencies increased in the earlier months of the pandemic, however since mid-July the number of delinquent accounts have returned to pre-COVID 19 levels. As a result of the limited impact so far and the Authority's ability to mitigate revenue loss through the above mentioned expenditure adjustments, the Authority is not expecting a material change in net revenues in FY 2020. Moody's regards the coronavirus outbreak as a social risk under its ESG framework, given the substantial implications for public health and safety.

Notwithstanding the improvement made by the Authority to address several legal uncertainties and managing COVID-19 exposure, uncertainty still remains as to whether Santee Cooper will be reformed or sold. We expect this issue to be addressed during the General Assembly session that will begin in January 2021. If Santee Cooper were to be sold, it is fair to assume that South Carolina would include terms which guarantee that the utility's obligations under the settlement would be taken over by the purchasing party.

RATING OUTLOOK

The stable outlook captures improved visibility regarding Santee Cooper's financial profile over the next few years thanks to the settlement of a major lawsuit in August, and anticipated interest cost savings from the current refunding as well as future forecasted refundings. Although some uncertainty remains regarding the utility's future governance, management maintains some flexibility with respect to operations in order to deliver on its strategy of maintaining targeted debt service coverage ratios, rate competitiveness, and stable levels of liquidity.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- Further mitigation steps are executed to reduce leverage caused by the Summer project through a combination of expenditure reductions, new revenues, refinancing opportunities, and customer growth
- Following the lifting of the rate freeze, governance is reestablished which provides more transparent certainty around cost recovery;

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Three year average fixed charge coverage falls below 1.30x and liquidity is consistently below 110 days;
- Further political influence weights on Santee Cooper's operations

LEGAL SECURITY

The bond resolution includes a sum-sufficient rate covenant and no debt service reserve account or additional bonds test but Santee Cooper must deposit annually into the Capital Improvement Fund an amount which, together with amounts deposited during the prior two years, equals 8% of required revenues in the preceding three fiscal years. As of June 30th, 2020, the capital improvement fund balance was \$123.6 million. These funds are typically used for debt service or for capital. The amount Santee Cooper is required to transfer to the state is restricted to a maximum of 1% of Santee Cooper's projected operating revenues. There is no external rate regulation except for federal regulation on transmission rates.

USE OF PROCEEDS

Proceeds from the 2020 A&B bonds are being used to fund a portion of the issuer's on-going capital improvement program, refund a portion of outstanding senior debt and pay costs of issuance. The \$363.1 million from Series 2020A comprises \$92.3 million of new money issuance and \$270.7 million towards the refunding of Series 2009A, 2010A, 2014C, 2016A and 2016B. The \$300.4 million proceeds from Series 2020B will go towards refunding Series 2012A and 2012D. The combined NPV refunding savings from the refunding is estimated at roughly \$140 million.

PROFILE

South Carolina Public Service Authority (Santee Cooper) is a component unit of the State of South Carolina (GO bonds rated Aaa) and was created by the State Legislature in 1934. It is governed by a 12 member board of directors, 7 year staggered terms, appointed by the Governor with the advice and consent of the Senate. One board member has to come from each congressional district in the state and each of the Authority's direct-serve counties and a chairperson appointed at large. The Authority provides electric service, retail and wholesale, and wholesale water supply in several regions of the state. It also serves in other capacities including flood control; real estate management; park management and economic development assistance for local communities.

The Authority's assets include wholly owned and ownership interests in a variety of coal, natural gas, nuclear, hydro, biomass, landfill and solar generating units totaling 5,112 megawatts (MW) of summer power supply peak capability. This consists of 3,500 MW of coal-fired capacity, 1,117 MW of natural gas and oil capacity, 322 MW of nuclear capacity, 142 MW of hydro capacity, 29 MW of landfill methane gas capacity and 3 MW of solar capacity.

The Authority may purchase from, sell to or exchange with other bulk electric suppliers additional capacity and energy in order to maximize the efficient use of generating resources, reduce operating costs and increase operating revenues. The Authority also operates an integrated transmission system which includes lines owned by the Authority as well as those owned by Central, the Authority's largest wholesale customer.

METHODOLOGY

The principal methodology used in these ratings was US Public Power Electric Utilities with Generation Ownership Exposure Methodology published in August 2019 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1170209. Alternatively, please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004

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